

Gold. Just Another Thought.

Gold.

To determine the value of an object one has to determine its usefulness. To determine the price of an object one has to understand the convolutions of the collective human mind.

More than half of gold production per annum is used to make jewellery. The jewellery industry's margins are so diverse that it makes an analysis of the value of gold as a factor of production difficult. Gold is also used as a type of currency. Since all currencies are denominated in one another, the act of backing a currency by gold is to make gold a currency. The value of having gold as a currency against which to peg was that the supply of gold was limited (but not fixed) and making it a useful standard of measure. The problem with using gold as a standard was that monetary policy lost a degree of freedom, namely the potential for central banks to print money freely without encumbrance. Every action has consequences, however, and not backing a currency with gold and thus being able to print unlimited amounts of money has other consequences, some of which will undoubtedly surface in the coming years.

Gold also has some industrial uses where an analysis of marginal productivity and cost are possible but the impact on the gold market is negligible.

The period following any sufficiently acute financial crisis tends to rekindle the idea of going back on the gold standard. Fear and doubt surrounding the validity and value of fiat currency spurred a massive rally in gold from 2008 – 2011. Since then the stabilization of the financial system has seen a steady decline in the price of gold. As the price of gold languishes, and the price of other assets begin to lose momentum, attention occasionally returns to gold. For gold to

rally sustainably, faith must falter or fail in all other credible alternative stores of value. That means there must be sufficient volatility in the currency majors, notably the USD, there must be widening credit spreads in investment grade, there must be volatility in US treasuries and other major sovereign bonds. Volatility in equities and high yield bonds don't count so much since they are speculative and not seen as stores of value but as generators of value. When the volatility in the US treasury market fell off in late 2011, gold began its decline. So, the question one should ask in contemplating the prospects for gold are, will there be a wholesale existential threat to the major sovereign and investment grade credit markets in the world and at the same time will currency volatility pick up between the currency majors.